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CANADIAN INSTITUTIONAL RESEARCH REPORT

THE MERCANTILE BANK OF CANADA

September 1972

BACHE & CO.

CANADA LIMITED

MEMBERS: ALL LEADING EXCHANGES
FOUNDED 1879

PRUDENCE DICTATES CAUTIOUS INVESTMENT POSTURE

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THE MERCANTILE BANK OF CANADA

CURRENT MARKET DATA

Current Price* ("MBC" - T.S.E., MSE)		$ 28.50
Price Range for 1972		$ 30.00-18.50
Investment Opinion		
Estimated Trading Range (6-12 Months)		$ 20 - 16
Fiscal Year End October 31st		
Earnings Per Share	- 1971	$ .96
	- 1972e	$ 1.02
	- 1973e	$ 1.13
	- 1974e	$ 1.12
	- 1975e	$ 1.12
Price-Earnings Ratio	- 1972e	27.9x
	- 1973e	25.2x
	- 1974e	25.4x
	- 1975e	25.4x
Indicated Annual Dividend Per Share		$ .50
Current Common Stock Yield		1.75%
Number of Common Shares Outstanding**		3,000,000
Estimated Common Share Public Float		1,000,000

* - Priced as of August 31, 1972. e - estimated

**- First National City Bank owns 65% or 1,935,000 of the outstanding common stock.

TRADING VOLUME

1972	TSE	MSE	TOTAL
May	57,600	2,960	60,560
June	54,190	21,768	75,958
July	38,620	20,282	58,902
Volume to Date	150,410	45,010	195,420

Ratio of total volume traded to date to total number of common shares outstanding: 6.51%

DISTRIBUTION OF CAPITAL PAR VALUE $5.00 STOCK AS OF APRIL 14, 1972

Number			Shares
28	..... Holders of	1 - 24 share lots	405
629	..... " "	25 - 99 " "	26,050
415	..... " "	100 - 199 " "	43,900
104	..... " "	200 - 299 " "	21,895
37	..... " "	300 - 399 " "	11,565
25	..... " "	400 - 499 " "	10,425
80	..... " "	500 - 999 " "	44,495
163	..... " "	1000 - up " "	2,840,815
1,481	Shareholders	Total Shares	3,000,000

INVESTMENT COUNSEL

All our calculations from the vantage point of an initial $13 per share investor indicate $16.29 as the present value on each Mercantile Bank share discounted at the 8% historic rate.

We estimate future worth at $25.49 per share in 1978.

The current market price of $28.50 fully discounts the bank's optimistic earnings and dividend growth. We therefore recommend aggressive profit taking at current levels.

The investment ... bullish outlook of the Mercantile Bank's future outlook. This position would be attributed to several important considerations:

1. The Management's target achievement of 2% market share within the next six years compared with 0.46% in June 1972. (This market share is measured by the ratio of Mercantile Bank's total assets to the total assets of the Canadian chartered banks.)

2. Growth. In the Bank's future business is to be in the wholesale corporate financing area rather than the high volume retail business.

3. The nature of the [illegible] business supports the [illegible]

4. The [illegible] and foreign exchange trading, [illegible] million [illegible]

5. [illegible] as dividends while providing for [illegible] the bank. This distribution policy has considerable attraction for income investors.

6. Special By-Laws and Agreements approved by the shareholders and approved by the Governor in Council provide for the successive increases in the share capital of the Mercantile Bank.

The extent is to reducing to less than 25% the interest in the ownership interest of the First National City Bank. When this is achieved, the limitation on growth imposed by the Bank Act, para.75, (2)(c), will cease to apply. Mercantile Bank will then be able to increase total liabilities in excess of 20 times its $50 million authorized capital stock.

7. The equity financing (Special By-Laws & Agreements) is to be achieved through periodic rights to existing Canadian residents. In the absence of any substantial changes in the present laws (the Bank Act, the Income Tax Act and applicable securities laws, the Mercantile Bank's board of directors expect the exercise price per share for future rights issues to be $6.75-$7.00, the approximate book value per share.

8. The exercise of rights makes capital gains and certain general tax advantages to the investors. Should all the available rights be exercised by the typical investor at the issue price of $15 per share, we calculate $8.49 as the theoretical capital gain. An individual tax payer depending upon his personal tax rate could conceivably escape this 50% tax liability as it has the effect of reducing the original cost of his investment to $8.11 per share from $15.00 per share.

SUMMARY OF FACTORS BEHIND RECOMMENDATION

BULLISH FUTURE OUTLOOK

The investors' willingness to pay the current market price suggests their bullish fervour on the Mercantile Bank's future outlook. This positive sentiment could be attributed to several important considerations:

1. The management's target achievement of 2% market share preferably within the next six years compared with 0.66% in June 1972. (The market share is measured by the ratio of Mercantile Bank's total assets to the total assets of the Canadian chartered banks.)

2. Growth in the bank's future business is to be in the wholesale corporate financing area rather than the high volume retail business.

3. The nature of the contemplated banking business suggests low overhead to support growth and the consequent ability to earn wider profit margins than the industry average.

4. The above revenue base will be supplemented by activity in both spot and forward exchange trading, with turnover currently between $600 million-$800 million a month.

5. The declared management philosophy is to distribute 90% of earnings as dividends after providing for appropriations for losses. This distribution policy has considerable attraction for income accounts.

6. Special By-Law E and Deposit Agreement enacted by the shareholders and approved by the Governor in Council provides for six successive increases in the share capital of the Mercantile Bank.

   The object is to reduce to less than 25% from the current 65% the ownership content of the First National City Bank. When this is achieved, the limitation on growth imposed by the Bank Act, para.75, (2)(g), will cease to apply. Mercantile Bank will then be able to increase total liabilities in excess of 20 times its $40 million authorized capital stock.

7. The equity financing Special By-Law E necessitates is to be achieved through periodic rights to existing Canadian residents. In the absence of any relevant change in the present laws, including the Bank Act, the Income Tax Act and applicable securities laws, the Mercantile Bank's board of directors expect the exercise price per share for future rights issues to be $6.75-$7.00, the approximate book value per share.

8. The exercise of rights endow capital gains and certain assumed tax advantages on the investors. Should all the available rights be exercised by the initial investor at the issue price of $13 per share, we calculate $4.69 as the theoretical capital gain. An individual tax payer depending upon his personal tax rate could conceivably assume this to be his tax liability as it has the effect of reducing the original cost of his investment to $8.31 per share from $13.00 per share.

Should an investor prefer to sell the rights rather than exercise them, then the proceeds could at least be treated as capital gains in the hands of the recipients. It is therefore in the investors interest not to sell the rights but exercise them always and perhaps later sell the converted common stock.

Random thoughts on the tax situation delineated above should not be construed as definitive; the investor is therefore advised to seek proper professional counsel elsewhere.

Favourable Factors Fully Discounted

The favourable factors cited above in our estimation are fully discounted in the current market price. Reasons for this investment opinion are:

1. The growth in the Mercantile Bank's business is conditioned by the periodic leverage obtained from net worth. The limitation on expansion will prevail until such time as the Citibank's ownership is reduced to less than 25%. Since this pace cannot be quickened without unduly diluting earnings growth, a ceiling on expansion is assumed to prevail over the next eight years.

2. We believe the management philosophy is not to wait until December 31, 1980 to achieve 75% Canadian ownership of the Mercantile Bank. It could seek to achieve this target inasmuch as six years, thus forcing an above average annual dilution rate.

3. Assuming from the standpoint of an initial investor that the future six equity financing occur at a prescribed annual rate, then we estimate the full advantage of the leverage in each year to be fully neutralized by the issue of new stock. (The investor should note that since one right has already been exercised in March 1972, only five more rights remain in the future.)

4. The 2% market share will be difficult to attain in the time span contemplated by the Mercantile Bank without sacrificing profit margins. The bigger the bank grows, the lower will be its profit margins. We here note the conflict in goals. Should management emphasize the goal of market share (which is the same thing as volume), profitability targets will have to be sacrificed and vice versa. We base our view on the contemplated character of the banks business and the reaction of the bigger banks. The stronger the bid the Mercantile makes to capture a larger slice of Canadian wholesale financing, the more virulent will be the reaction of the Big Five chartered banks to meet competition on equally favourable terms.

5. The small size of the retail business will force the Mercantile Bank to borrow funds on an increasing scale in the domestic and the foreign markets. This should expose the bank to two types of risks associated with changes in interest rates and exchange rates.

   Insofar as the interest rate risk is concerned, the sudden and sharp increases in domestic or foreign rates will cause an instant squeeze on profit margins. Depending upon the term of the loans, the higher

deposit cost could be absorbed only after a lag of 90 to 180 days.On the other hand, the reverse probability of enlarged profit margins with a decline in short-term interest rates also exists. In any case, we wish to draw the investors attention to the cyclical pattern of earnings growth to which the bank is subject.

Likewise, the exposure to the exchange risk is high since foreign funds largely supplement domestic deposits. Foreign deposits as a percentage of total deposits have tended to fluctuate as high as 57% in 1967 and as low as 38% in 1971. The dependence on foreign funds is a function of interest rates in North America. If, Canadian hedged funds are cheaper, it is not profitable to import capital and vice versa. Now to the extent Mercantile Bank employs foreign funds chiefly in the domestic market, unlike the Big 5 who mainly deploy them abroad, it is incurring the additional cost of forward exchange cover.

6. First National City Bank has extended to Mercantile a renewable $30 million line of credit for loans having a 180 days maturity. Mercantile will pay Citibank its base rate for 90 day loans on all drawings made under the agreement, with a stand-by fee of ¼% of 1% per annum on the average daily unused portion. However, more than offsetting this advantage is the three year Management Services Agreement. Citibank has agreed at a fee exceeding $250,000 annually to furnish advice and expertise to the Mercantile Bank. The management fee in our view should further increase the operating costs as enough talent exists within the country to provide the type of service Mercantile Bank intends to purchase.

7. Our calculations on the assumptions of:
   - a 5% perpetual yield
   - 95% payout (rather than 90% ratio) and
   - $.89 dividend per share paid in the base year 1972

   suggest an estimated 1978 income value of $20.80 in each Mercantile Bank common stock.

8. Applying the 8% historic discount factor over the divergent time horizons for capital gains and income, we derive $16.29 as the present worth for each Mercantile Bank share :

Estimated Market Value of Each Mercantile Bank Common Share

Present value of capital gains secured from periodic rights exercise (derived on page 8)	$ 3.19
Present income value in each common stock (derived on page 17)	$ 13.10
Estimated present market value per share	$ 16.29

9. Therefore, in our opinion, the current market price of $28.50 grossly over-values the promising prospects of the Mercantile Bank.

THE MERCANTILE BANK OF CANADA

Corporate Background

The Mercantile Bank, incorporated on March 31, 1953 by a Special Act of the Canadian Parliament, is a subsidiary of the First National City Bank (Citibank), U.S.A., which currently owns 64.5% of the 3 million outstanding common stock. The company has its main office at Montreal, Quebec.

The Mercantile employs 325 persons and provides wholesale banking services throughout Canada through an 8 branch network in Calgary, Edmonton, Halifax, Montreal, Quebec City, Toronto, Vancouver and Winnipeg. The bank is examining the potential of communities across Canada to determine the best locations for future expansion at an annual rate of one new branch. Operations are organized on a geographical basis into 3 regions each supervised by a regional general manager who reports to the president. Support for required operations is provided from the main office, which itself is organized into five areas: accounting, credit supervision, inspection, investment and exchange, and personnel and corporate planning.

Of the three regions the business of the Eastern region is concentrated in the secondary manufacturing, service and resource industries, as well as financial institutions. New business in 1971 was derived from the resource sector. New relationships included aluminum production, mining transportation and equipment leasing. Further growth in 1972 is anticipated in the secondary manufacturing (due to faster writeoffs) and merchandising sectors,petroleum and realty fields. The Federal and provincial governments' efforts in the Maritimes to create new investment opportunities should also provide an impetus to make more business loans in that area.

The Ontario region had the fastest growth, with a 32% loan expansion in 1971. Important accounts include auto, aircraft and printing manufacturers, financial institutions, service industries, interim or bridge financing for the construction industry and participation in commercial property development.

In the Western region no one industry group dominates the loans portfolio. Client relationships include companies in the forest products industry, wholesaling, retailing, public utilities, construction, trucking and finance. The company hopes to make inroads in the oil and gas market in Alberta and the Canadian North through the expertise of its Oil and Gas Department. The $4 billion pipeline project, to transport natural gas from the Arctic Islands and Prudhoe Bay as well as from other areas in the Canadian Arctic, will be underway in 1973 and will require large financing assistance.

Overall, the bank has strength disproportionate to its size in the total Canadian chartered banks' business loans, with the largest relative shares in the resource industries, public utilities, transportation and communications. The Mercantile Bank commanded a 0.65% market share ($385 million) in June 1972 as measured by the total assets of the Canadian chartered banks ($57,930 million). According to a statement attributed in March 1972 to Mr. Paul H. Austin, a 2% market share is the bank's target. "We've got a lot of elbow room to grow, and we are not going to crowd anybody", he said.

The bulk of the bank's earnings assets consist of commercial loans made to corporate borrowers. Most of the loans are due on demand and should at least bear interest at about 1% over the prime rate. Approximately 75% or $182 million

of the $242 million outstanding loans as at October 31, 1971 consisted of loans of $1 million or more. Personal loans did not exceed $12 million in the same period. A breakdown in Table 1 of the loans composition indicates high predominance of loans in Canadian currency. The foreign currency loans as a ratio of total loans declined to 9% in June 1972 against 40% in 1967. As loans range from 81%-96% of total deposits, the size is small of the bank's investment portfolio.

TABLE 1

LOANS COMPOSITION ($ MILLION)

	1967	1968	1969	1970	1971	As at June 30.1972
Day,call & others	$ 10.86	$ 4.28	$ 2.04	-	$ 9.21	$ 5.49
(% to total loans)	6.57%	2.91%	1.24%	-	1.80%	1.68%
Loans in Cdn. currency ..	$ 87.50	$111.47	$150.10	$158.86	$209.93	$290.78
(% in total loans)	52.93%	75.76%	91.22%	97.53%	86.67%	89.33%
Foreign currency loans...	$ 66.94	$ 31.38	$ 12.40	$ 4.02	$ 23.08	$ 29.26
(% to total loans)	40.50%	21.33%	7.54%	2.47%	9.53%	8.99%
Total loans	$ 165.30	$147.12	$164.55	$162.88	$242.22	$325.53
Total deposits	$ 203.43	$164.73	$174.37	$169.00	$260.03	$336.61
Loans/deposits ratio.....	81.26%	89.31%	94.37%	96.38%	93.15%	96.71%

Unlike the Canadian chartered banks, the major portion of the Mercantile Bank's deposits as shown in Table 2 consist of borrowed short-term funds, obtained at competitive rates from money market sources. The cost of such deposits vary widely with their availability, monetary policy and general economic conditions. The bank also obtains corporate demand deposits and deposits by Canada and the provinces. In the absence of a sizable branch network, personal savings deposits do not provide a large part of the loanable funds. A third important source is foreign deposits which averaged 48% in the period November 1967-June 1972 and which as a percent of total deposits have gone as high as 57% in 1967 and as low as 38% in 1971.

TABLE 2

DEPOSITS STRUCTURE ($ MILLION)

	1967	1968	1969	1970	1971	As at June 30,1972
Demand deposits	$ 33.18	$ 41.03	$ 29.85	$ 32.36	$ 37.23	$ 39.36
(% to total deposits)..	16.31%	24.91%	17.12%	19.15%	14.32%	11.69%
Term deposits	$ 54.09	$ 48.32	$ 56.14	$ 67.68	$ 124.88	$ 108.98
(% to total deposits)..	26.59%	29.33%	32.20%	40.04%	48.03%	32.38%
Foreign deposits	$ 116.16	$ 75.38	$ 88.37	$ 68.96	$ 97.92	$ 188.27
(% to total deposits).	57.10%	45.76%	50.68%	40.81%	37.65%	55.93%
Total Deposits	$ 203.43	$ 164.73	$ 174.36	$ 169.00	$ 260.03	$ 336.61

$30 Million Credit Pool

In addition, by a letter of agreement dated February 1, 1972, Citibank has extended to Mercantile a U.S. $30 million line of credit available for loans having a maturity of up to 180 days. Each drawing under the line of credit is not to be less than U.S. $1 million. Mercantile has promised at the time of each drawing to pay interest on these funds at Citibank's base rate for 90 day loans made to responsible and substantial commercial borrowers (the floating prime rate). Unless renewed, the line of credit expires on January 31, 1973.

Mercantile has also agreed to pay the Citibank a commitment fee of ¼% of 1% per annum on the average daily unused portion of the line of credit.

By another agreement, "Management Services Agreement", dated February 1, 1972 and subject to renewal after 3 years, Mercantile has promised to reimburse Citibank the fair cost of such services as:

- advise and expertise with respect to a wide range of banking and management techniques,
- loan of key Citibank personnel on a full-time basis and
- special services related to foreign currency transactions.

The management estimates that the annual cost of this agreement will represent an increase of $225,000 per year over the cost of such services prior to 1972.

Future Financing

Capitalization as at August 31, 1972*

Capital Stock:		
4,000,000	authorized common shares $5 par value	
	3,000,000 issued common shares	$ 20,000,000
	Rest account**........................	4,750,000
	Retained income	706,736
	Total capitalization	$ 20,456,736

* *After giving effect to two-for-one stock split declared on January 30, 1972.*

** *An increase of $1.75 million in the rest account represents the excess of the proceeds to the bank over the aggregate par value of the 1,000,000 shares issued in February, 1972.*

Prior to 1972 Mercantile was 96.7% owned by Citibank and was therefore subject to the Bank Act, Paragraph 75(2)(g). Under this provision effective January 1, 1968 Mercantile could not expand its business beyond its current level as long as 25% of the issued shares were held by any one resident or non-resident shareholder and his associates. Mercantile was hence not to have outstanding liabilities (including paid-up capital, rest account and undistributed profits) exceeding 20 times its authorized capital stock. By virtue of Citibank's total ownership prior to 1972, the bank's total liabilities and assets were freezed at $200 million or 20 times the $10 million authorized capital.

At the request of the Mercantile Bank this limitation was removed when the Governor in Council approved Special By-Law E and the Deposit Agreement. The said Order provides for increases in the capital authorized to $40 million from $10 million by way of six successive increases of $5 million each. The first increase of $5 million took effect on February 23, 1971 and the second leading to $20 million took effect when the shares constituting the second increase were acquired by Canadian residents. Each successive $5 million increase in the authorized capital will continue until it reaches $40 million from the current $20 million, at which time, Citibank will hold less than 25% of the issued shares. On reaching the $40 million mark only can the Mercantile Bank's operations exceed the 20 times its authorized capital.

The increase in capitalization must be completed by December 31, 1980 or earlier. Under the Bank Act, on each occasion of an increase in the issued capital, the additional shares should be offered to eligible persons who are shareholders according to the books of the bank, pro rata, at such price not less than par as the directors should determine. In the absence of any relevant change in the present laws, including the Bank Act, the Income Tax Act and the applicable securities laws, the Mercantile Bank expects to carry out subsequent share issues through the issue of transferable rights to its then existing shareholders. As these rights will not be exercisable by non-residents including Citibank, their rights quota will be sold to eligible Canadian residents.

EXTENT OF PERIODIC STOCK DILUTION

Period	Rights Ratio	Dilution Expected Per Period	Common Stock Outstanding End of Period
March 1972	-	-	2,000,000
First right (1972 ...	1 for 2	33%	3,000,000
Second right (1973)..	1 for 3	25%	4,000,000
Third right (1974) ..	1 for 4	20%	5,000,000
Fourth right (1975)..	1 for 5	17%	6,000,000
Fifth right (1976)..	1 for 6	14%	7,000,000
Sixth right (1977) ..	1 for 7	12%	8,000,000

Note: *The deadline for completion of new equity financing is December 31, 1980. However, for purposes of simplification an annual stock dilution is assumed, so that the financing is estimated to be completed by December 31, 1977.*

Rights At Book Value

The exercise price per share for the future rights issues will be determined by the board of directors at the time of each issue on the basis of the circumstances then prevailing. However, having regard to the paramount interest of the bank in freeing itself from the restrictions on the amount of its assets and to the view that the bank will not in the meantime be in need of substantial additional equity capital, the board of directors have expressed the opinion that the exercise price for the future rights issues will be approximately the book value at the time of each issue, which in our opinion could be in the range of $6.75-$7.00 per share.

SHARE ISSUES DURING PAST TEN YEARS

During its past ten financial years ended October 31 and to date in its current financial year, the bank has issued shares as follows:

Date of Issue	No.of Shares Issued (1)	Amount Realized Per Share	Total Amount Realized	Purpose of Issue
December 21,1961	200,000	$ 5.00	$ 1,000,000	In each case
July 2,1965	800,000	6.25	5,000,000	expansion of
April 18,1967	400,000	6.25	2,500,000	the business
March 5-29,1972	32,001	6.75	216,006.75	of the bank
March 30,1972	967,999	6.75	6,533,993.25(2)	

Notes: 1. After two-for-one split effective January 30, 1972.
2. Before deducting estimated expenses at $95,000.

CAUSES OF INVESTOR OPTIMISM

We believe two factors relating to the company's future common stock performance govern investor optimism:

Right of pre-emption at or near the prescribed $6.75 book value per share, and

a prospective generous dividend distribution policy.

In our opinion, the periodic exercise of rights constitutes capital appreciation to an investor, whereas the dividends paid make up the income feature. The sum of the two components is considered to be the rate of return on investment. Moreover, as the management philosophy is to distribute 90% of the annual earnings after making appropriations for losses, we are inclined to look upon the stock's valuation as a variable function of income.

Capital Appreciation

The need for future financing and the manner in which it is to operate suggests capital appreciation to the initial common stock holders. On the basis of periodic, rights assumed to be exercised every year by the initial investor in the manner prescribed, we summarize the cumulative capital growth value in the stock as follows:

PERIODIC VALUE IN RIGHTS TO THE INITIAL INVESTOR

FIRST RIGHT

Market price of 1 common share at issue (March 1, 1972)		$ 13.00
2 Common shares needed for purchase of 1 common share	$ 26.00	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 3 shares	$ 32.75	
Average cost per share		$ 10.92
Value of first right		$ 2.08

SECOND RIGHT

Market price of 1 common share (average cost per share in the previous period)		$ 10.92
3 Common shares needed for purchase of 1 common share	$ 32.75	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 4 shares	$ 39.50	
Average cost per share		$ 9.87
Value of second right		$ 1.05

THIRD RIGHT

Market price of 1 common share (average cost per share in the previous period)		$ 9.87
4 Common shares needed for purchase of 1 common share	$ 39.50	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 5 shares	$ 46.25	
Average cost per share		$ 9.25
Value of third right		$ 0.62

FOURTH RIGHT

Market price of 1 common share (average cost per share in the previous period)		$ 9.25
5 Common shares needed for purchase of 1 common share	$ 46.25	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 6 shares	$ 53.00	
Average cost per share		$ 8.83
Value of fourth right		$ 0.42

FIFTH RIGHT

Market price of 1 common share (average cost per share in the previous period)		$ 8.83
6 Common shares needed for purchase of 1 common share	$ 53.00	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 7 shares	$ 59.75	
Average cost per share		$ 8.54
Value of fifth right		$ 0.29

SIXTH RIGHT

Market price of 1 common share (average cost per share in the previous period)		$ 8.54
7 Common shares needed for purchase of 1 common share	$ 59.75	
Exercise price for 1 additional common share (at book value)	$ 6.75	
Total cost of 8 shares	$ 66.50	
Average cost per share		$ 8.31
Value of sixth right		$ 0.23

SUMMARY OF CUMULATIVE VALUE IN RIGHTS

Right Number	Theoretical Value in Each Right
One	$ 2.08
Two	1.05
Three	.62
Four	.42
Five	.29
Six	.23
Total value in all the rights	$ 4.69

CAPITAL APPRECIATION ACCRUING TO AN INITIAL INVESTOR

Cost of 1 common stock at issue price	$ 13.00	
Average cost of 1 common stock after exercise of all the available rights	$ 8.31	
Reduction in cost valuation		$ 4.69
or		
Capital appreciation assumed in rights exercise		
5 Year waiting period on the rights (1972-77) discounted at 8% the historic rate yields		x .681
The present value in future rights		$ 3.19

Note: *All investors should recognize that the tax on capital gains is levied only when the capital gain is actually realized.*

Tax Benefit

The derived cumulative capital appreciation of $4.69 per share can be viewed either as a reduction in the original purchase price of the common stock or the cumulative value of the future rights inherent in the $13 per share issue price. It cannot be deemed to be both a reduction in the average cost of investment as well as a capital gain. Such an assumption would be erroneous in our view as it involves double counting of benefits endowed on the initial purchaser.

A proforma bookkeeping nature of the transactions is shown in Tables 3 and 4 to calculate the gross and after-tax capital gains accrued. As the Mercantile Bank shares were issued at the beginning of this year, the post-Valuation Day format is adopted as indicated in the Financial Post (March 4, 1972). In making the hypothetical calculations it is important for the investor to remember the underlying assumptions:

To realize maximum capital gains, an investor must have bought the shares at their $13 issue price.

He is expected to hold his stock right up to the period when the sixth right is exercised. (As a result of this assumption, the column on "number of shares sold" in Table 3 reveals no transactions.)

On completion of the proposed rights issues, the investor is assumed to sell his entire holdings in a single transaction. This method is employed purely for simplification of exposition. An investor can assume any number of permutations and combinations of sell transactions for his personal satisfaction.

We assume gross capital gains realized to be a function of market price. The assumed $30 per share market price is just a number. There is no certainty that this price will prevail tomorrow let alone in 1977.

In calculating the tax on capital gains a simplification has again been used. All taxpayers will be required to add back 50% of their total capital gains into their taxable income and later apply the marginal tax rates applicable to that global number. However, since we are not familiar with the ordinary income of each investor nor the presence or absence of capital loss if any in that year, we have merely applied the personal tax rates to the total capital gains to derive the after-tax capital gains.

In terms of the above assumptions, if Mercantile Bank shares are sold at $30 per share, the net proceeds from the sale are $29.60 per share. Likewise, an assumed initial portfolio of 200 Mercantile Bank shares is finally built up to 800 shares at an average total cost of $6,648. On the basis once again of $30 per share, the total net proceeds are $23,684 from which deduction of $6,648 as the average total cost yields $17,036 as the total capital gains.

Remember, this capital gains can only accrue if an investor held his stock over the next five years and the tax liability arise only when the capital gains are realized. To that extent, we assume no change in personal tax levels.

(This, of course, seems unrealistic from experience; taxes have a tendency to increase not decrease.) In any case, because of the time horizon, we have to discount the capital gains advantage into the present. Under these circumstances, the after-tax capital gains advantage varies from $14.50 per share to an investor who pays no taxes to $10.88 for one with a 50% personal tax rate.

On the other hand, the full tax advantage may not arise to an investor selling (or buying) the rights in the open market. To quote from the Mercantile Banks' prospectus, "The Ruling Division of the Department of National Revenue, Taxation, has issued an advance ruling to the Bank to the effect that if the exercise price for a rights issue made in any year is less than the actual book value of the shares at the time of such issue, a benefit or advantage will be considered to have been confirmed on the shareholders, the value of which must, in the case of shareholders resident in Canada, be included in computing their income in the year." In simple language, according to the ruling, capital appreciation realized by Canadian residents on the sale of rights would be treated as income rather than capital gains in the hands of the recipients.

We understand the Ruling has been appealed. If the past is any guide, probability favours a reversal of this Ruling. It is our belief that in the past when rights were issued by other Canadian chartered banks, the sale proceeds were treated as capital gains and as such no tax was payable since they were tax exempt. However, now that capital gains are taxable, there is no valid reason to depart from the past practice. We are therefore confident, and this is clearly an expression of opinion, that sale proceeds from the rights may be treated as capital gains only for tax purposes. It is therefore advisable not to sell the rights but to exercise them. In any case, we are unable to comment definitively on the entire tax situation, the investor is advised to seek proper professional counsel elsewhere.

TABLE 3

CAPITAL GAINS ACCRUED*

Date	No.of Shares Bought	No.of Shares Sold	Balance Held	Market Price P.S.	Cost of Purchase (including brokerage)	Average Adjusted Cost of Shares Held Per Share	Average Adjusted Cost of Shares Held Total Cost	Adjusted Cost Base (Cost of Shares Sold)	Net Proceeds (after deducting brokerage and transfer taxes) Per Share	Net Proceeds (after deducting brokerage and transfer taxes) Total	Capital Gains(loss)
March 1972	200	-	200	$ 13.00	$ 2,600	$ 13.00	$ 2,600				
April 1972	100	-	300	6.75	675	10.92	3,276				
1973	100	-	400	6.75	675	9.87	3,948				
1974	100	-	500	6.75	675	9.25	4,625				
1975	100	-	600	6.75	675	8.83	5,298				
1976	100	-	700	6.75	675	8.54	5,978				
1977	-	-	800	6.75	675	8.31	6,648				
Single Transaction Sale											
Dec. 1977	-	800	-	$ 30.00	-	$ 8.31	$ 6,648	-	$ 29.60**	$ 23,684	$17,036

* - *Assumed to keep initial holdings until all rights received.*

** - *Brokerage $38.50 per 100 shares = $308.00. Plus Ontario transfer tax at 1¢ per share = $8.00. Total cost $316 ($308 + $8) deducted from total sale proceeds $24,000, gives us net sale proceeds of $23,684.*

TABLE 4

HYPOTHETICAL AFTER-TAX CAPITAL GAINS

	Individual's Personal Tax Rates					
	0%	10%	20%	30%	40%	50%
Capital gains if all stock sold in a single transaction..	$17,036.00	$17,036.00	$17,036.00	$17,036.00	$17,036.00	$17,036.00
Portion of capital gains to be included in taxable income.	$ 8,518.00	$ 8,518.00	$ 8,518.00	$ 8,518.00	$ 8,518.00	$ 8,518.00
Hypothetical tax payable on capital gains and included in taxable income	$ nil	$ 851.80	$ 1,703.60	$ 2,555.40	$ 3,407.20	$ 4,259.00
Hypothetical net capital gains over 5 years	$17,036.00	$16,184.20	$16,032.40	$14,480.60	$13,628.80	$12,777.00
Capital gains/share on the assumption of 800 shares held.	$ 21.30	$ 20.23	$ 20.04	$ 18.10	$ 17.04	$ 15.97
Discounted to present worth at 8% historic rate or .681 factor	$ 14.50	$ 13.78	$ 13.65	$ 12.33	$ 11.60	$ 10.88

Dividend Policy

The second investment attraction in the Mercantile Bank relates to the dividend policy which is to be periodically set by the company's board of directors on the basis of earnings, financial requirements and other related factors. The management is confident that the current and future equity capital of the bank will be sufficient to conduct satisfactory operations and therefore it is not expected that a substantial amount of earnings will be retained in business. Accordingly, the bank's board of directors have passed a resolution declaring that it is their policy to distribute to shareholders by way of dividends approximately 90% of the annual profits "so long as such distribution shall be lawful and prudent in the light of prevailing conditions". It is our understanding that the 90% payout ratio applies to balance of revenue after making a provision for appropriations for losses.

The Bank Act provides that no division of profits exceeding 8% per annum on the paid-up capital of a bank shall be made by a bank unless, after making the division, such bank has a rest account equal to at least 30% of its paid-up capital after making all the necessary provisions for ascertained and estimated diminution in the value of assets. Insofar as the Mercantile Bank is concerned its prospectus discloses a pro forma rest account of $4.75 million or 31.67% of its paid-up capital. Hence we do not expect the Bank Act limitation on dividends to apply to the proposed dividend policy.

It is quite conceivable that total dividends to be received by the shareholders in accordance with the proposed policy may not be fully reflected in the quarterly dividends declared. We expect the company to supplement such quarterly payments by special distributions at the end of the fiscal year, similar to the practice prior to 1972 of the Bank of Nova Scotia and the Bank of Montreal.

In light of the avowed distribution policy, the stock is strictly assumed to be a situation for clients with income as their objective. Therefore, its value in the market place will be determined by the anticipated receipt of future dividends. One method of doing this would be to sum up the expected stream of dividends and to discount appropriately the sum into the present. Since this technique is useful where a capital equipment is involved, the method is inappropriate for application to a chartered bank. We have therefore devised the alternative technique of demanding a 5% perpetual yield on the stock. Thus, if the yield is held constant, dividends expected to be received over our assumed time horizon, should determine the market price. Dividends declared in their turn are contingent upon future earnings per share.

Net income (Table 7) is assumed to be a function of growth in the total assets (Table 5) and growth in the earnings assets at a constant profit margin (Table 6).

TABLE 5

ESTIMATED TOTAL ASSET GROWTH

	No. of Common Shares Outstanding	Equity Capital	Rest Account[2]	Shareholders' Equity	Leveraged Total Assets[3]
1972	$ 3.0 mil.	$ 15 mil.	$ 4.75 mil.	$19.75 mil.	$ .395 mil.
1973	4.0	20	6.75	26.75	.535
1974	5.0	25	8.75	33.75	.675
1975	6.0	30	10.75	40.75	.815
1976	7.0	35	12.75	47.75	.955
1977	8.0	40	14.75	54.75	1.095
1978	8.0	40	16.75	56.75	1.314[4]

Notes:
1. Each new share is assumed to be issued at $5 par value.
2. Surplus assumed to increase by $2 million annually after 1972.
3. 20x shareholders' equity.
4. Assumes 20% annual growth in business loans as after 1977 the 20x limitation is no longer applicable.

TABLE 6

ESTIMATED INCOME GROWTH TILL 1978

	1971	1972e	1973e	1974e	1975e	1976e	1977e	1978e
Total assets ($ billion) (assumes 38% annual compound growth rate over 1971 to achieve 2% market share)	.29	.40	.53	.67	.81	.96	1.09	1.31
Total deposits ($ billion) (assumed 90% of total assets)	.26	.36	.48	.60	.73	.86	.98	1.18
Total loans and investments ($ billion) (assumed 95% of total deposits)	.26	.34	.46	.57	.69	.82	.93	1.12
Gross income on earnings assets ($ million) (assumed 3% of total loans + investments)	7.80	10.20	13.80	17.10	20.70	24.60	27.90	33.60
Other income ($ million) (assumed 12% of gross income)	1.27	1.22	1.66	2.05	2.48	2.95	3.35	4.03
Total income expected ($ million)	9.07	11.42	15.46	19.15	23.18	27.55	31.25	37.63
Expenses other than interest ($ million) (assumed 20% annual compound growth over 1971 base)	5.25	6.30	7.56	9.07	10.89	13.06	15.67	18.81
Balance of revenue ($ million) (gross income less expenses other than interest)	3.82	5.12	7.90	10.08	12.29	14.49	15.58	18.82

e - estimated

TABLE 7

ESTIMATED EARNINGS GROWTH TILL 1978

	1971	1972e	1973e	1974e	1975e	1976e	1977e	1978e
Earnings Per Share								
Balance of Revenue ($ Million) . . . . (gross income less expenses other than interest)	3.82	5.12	7.90	10.08	12.29	14.49	15.58	18.82
Av. No. of common shares outstanding (Million)	2.0	2.5	3.5	4.5	5.5	6.5	7.5	8.0
50% taxed balance of revenue per share ($)	.96	1.02	1.13	1.12	1.12	1.12	1.04	1.18
Dividends Per Share								
Balance of Revenue ($ Million)	3.82	5.12	7.90	10.08	12.29	14.49	15.58	18.82
Appropriations for losses ($ Million) . . . . (assumed at 1/10 of 1% of total assets)	.20	.40	.53	.67	.81	.96	1.09	1.31
Bal. of rev. after loss appropriations ($ Million). .	3.62	4.72	7.37	9.41	11.48	13.53	14.49	17.51
50% taxed balance of rev.after loss app.($ Million) .	1.81	2.36	3.68	4.70	5.74	6.76	7.24	8.75
50% taxed balance of rev.after loss app.per share ($).	.91	.94	1.05	1.04	1.04	1.04	.97	1.09
Dividends Per Share ($). . . . . (assumes 95% payout ratio on 50% taxed balance of revenue after loss appropriations)	.86	.89	1.00	.99	.99	.99	.92	1.04

e - estimated

ANTICIPATED INCOME AND STOCK VALUATION

Having obtained a fix on the anticipated dividend income, the market price is derived in terms of the 5% perpetual historic yield. The formula employed to calculate market price is as under:

$$\text{Market Price} = \frac{\text{Dividend Expected Per Share}}{\text{Perpetual yield (assumed 5\% annual rate)}}$$

ESTIMATED FUTURE COMMON SHARE INCOME VALUE

Year	Expected Dividends Per Share	Estimated Future Value Per Share
1972	$ .89	$ 17.80
1973	1.00	20.00
1974	.99	19.80
1975	.99	19.80
1976	.99	19.80
1977	.92	18.40
1978	1.04	20.80

Note: *1. Future value per share is contingent on $.89 dividend per share paid in the base year 1972.*
2. Investor demands a 5% perpetual yield.
3. 95% of earnings after appropriations for losses are annually paid out. (95% rather than 90% payout ratio is assumed so as to be liberal in calculating the market price.)

ESTIMATED PRESENT INCOME VALUE IN EACH MERCANTILE BANK COMMON STOCK

Estimated Future Value Per Share in 1978	$ 20.80
Times 8% historic discount factor for the period 1972-78	x .630
Present Value	$ 13.10

Note: *The discount factor varies for capital gains (.681) and dividend income (.630) due to the assumed different time horizons. All rights are assumed to expire in 1977, whereas the full impact of the new capital on income is assumed to result in 1978.*

Conclusion

We recommend aggressive profit taking by investors in the Mercantile Bank, since the market price at current levels discounts overly the company's future optimistic outlook.

We base our recommendation on the premise that an initial investor seeks capital gains and dividend income, the former from the exercise of a total of six periodic rights and the latter from the 90% avowed payout ratio.

In our opinion, $4.69 is the theoretical calculated value in the rights in the assumed terminal year 1977 on the basis of $6.75 as the issue price for each new stock.

On the basis of the 8% historic discount factor, $3.19 is the derived present value in the rights.

The actual market value in the rights is assumed to be a function of the $13 initial investment cost and the $30 assumed market price. On the basis of an assumed single transaction sale and simplified tax applicability, the present worth of total capital gains is calculated to vary from $14.50 per share for an individual paying no taxes to $10.88 per share for an individual in the 50% personal tax rate.

We believe that dividends declared also play a critical role in determining the market value of Mercantile Bank's shares. On the assumptions of a 2% market share in the total assets of the banking system, a 3% earnings spread, 95% payout ratio rather than the declared 90% payout ratio and a 5% perpetual yield, we derive $20.80 as the 1978 estimated income value per share or $13.10 as the present value.

The calculated capital gains inherent in the periodic exercise of rights at the assumed $6.75 book value plus the estimated future income value per share based on a 5% yield, gives us $25.49 as the estimated 1978 market value or $16.29 as the derived present value for each Mercantile Bank share. In our view, the current market price overly discounts the company's optimistic outlook. We therefore recommend aggressive profit taking by all accounts at the current market.

September 1972

Kersi Doodha,
Canadian Research Department.

BACHE & CO.
CANADA LIMITED
CANADIAN RESEARCH DEPARTMENT

Mercantile Bank of Canada

Annual Statement 1972

BOARD OF DIRECTORS

Chairman
Walter B. Wriston

President
Paul H. Austin

Vice-Presidents
Hon. Louis P. Gélinas
Alfred T. Seedhouse

André Bachand
Director,
Development Fund,
University of Montreal

Hugh A. Benham
Executive Director,
The Winnipeg Foundation

J. Laurence Black
Chairman,
The New Brunswick Telephone Company Limited

Stephen C. Eyre
Senior Vice-President,
First National City Bank

John T. Johnson, Q.C.
Partner,
Borden, Elliot, Kelley & Palmer,
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President,
Mitchell Press Limited

Ronald D. Southern
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Atco Industries Ltd.

H. Arnold Steinberg
Executive Vice-President,
Administration and Finance,
Steinberg's Limited

Edward D. H. Wilkinson, Q.C.
Partner,
Russell & DuMoulin,
Barristers and Solicitors

EXECUTIVE OFFICERS

Duncan Campbell
Vice-President,
Ontario Region

John E. Cleghorn
Vice-President,
Western Region

Walter A. Prisco
Vice-President,
Eastern Region

E. Edward Fulcher
General Manager—Investment and Exchange

Harold F. Henry
General Manager—Credit

Gilles Lachance
General Manager—Personnel and Corporate Planning

G. Stevens Lynch
Secretary

T. Sean Ahern
Chief Accountant

John E. G. Morris
Chief Inspector

STATEMENT OF REVENUE, EXPENSES AND UNDIVIDED PROFITS

For the Financial Year Ended October 31, 1972
(with comparative figures for 1971)

	1972	1971
Revenue:		
Income from loans	$21,654,146	$16,082,159
Income from securities	1,157,102	1,424,983
Other operating revenue	2,029,571	1,653,905
Total revenue	24,840,819	19,161,047
Expenses:		
Interest on deposits	13,802,058	9,987,363
Salaries, pension contributions and other staff benefits	3,024,282	2,859,442
Property expenses including depreciation	1,193,799	946,564
Other operating expenses, including provision for losses on loans based on five-year average loss experience	2,117,287	1,547,257
Total expenses	20,137,426	15,340,626
Balance of revenue	4,703,393	3,820,421
Appropriation for losses	300,000	200,000
Balance of profits before income taxes	4,403,393	3,620,421
Provision for income taxes	1,945,000	1,835,000
Balance of profits for the year	2,458,393	1,785,421
Dividends	2,275,000	1,750,000
Amount carried forward	183,393	35,421
Undivided profits at beginning of year	138,541	603,120
	321,934	638,541
Transfer to rest account	–	500,000
Undivided profits at end of year	$ 321,934	$ 138,541
Balance of Profits per Share, Based on Average Shares Outstanding	95.2¢	89.3¢

STATEMENT OF ASSETS AND LIABILITIES as at October 31, 1972 (with c

ASSETS

	1972	1971
Cash and due from banks	$ 15,831,958	$ 13,701,779
Cheques and other items in transit, net	186,278	4,516,390
Total cash resources	16,018,236	18,218,169
Securities issued or guaranteed by Canada, at amortized value	9,180,781	13,249,949
Securities issued or guaranteed by provinces, at amortized value	1,552,190	–
Other securities, not exceeding market value	14,201,078	3,724,765
Total securities	24,934,049	16,974,714
Day, call and short loans to investment dealers and brokers, secured	13,850,000	9,212,201
Other loans, including mortgages, less provision for losses	319,102,363	233,008,545
Total loans	332,952,363	242,220,746
Bank premises, at cost, less amounts written off	1,767,449	1,152,741
Customers' liability under acceptances, guarantees and letters of credit, as per contra	13,254,107	9,296,374
Other assets	1,077,874	611,437
	$390,004,078	$288,474,181

Auditors' Report to the Shareholders

We have examined the statement of assets and liabilities of The Mercantile Bank of Canada as at October 31, 1972 and the statements of revenue, expenses, and undivided profits, accumulated appropriations for losses and rest account for the year ended on that date. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, the foregoing statements present fairly the financial position of the Bank as at October 31, 1972 and the revenue, expenses, changes in undivided profits, changes in accumulated appropriations for losses and transactions in the rest account of the Bank for the year ended on that date.

J. S. Grant, C.A.
of Peat, Marwick, Mitchell & Co.

Montreal, Quebec
November 29, 1972

J. E. Maheu, C.A.
of Maheu, Noël, Anderson, Valiquette et Associés

arative figures for 1971)

LIABILITIES

	1972	1971
Deposits by Canada	$ 1,214,538	$ 1,766,603
Deposits by provinces	12,145,524	4,436,529
Deposits by banks	92,093,196	10,443,142
Personal savings deposits, payable after notice in Canada, in Canadian currency	5,296,036	6,552,813
Other deposits	240,245,491	236,833,551
Total deposits	350,994,785	260,032,638
Acceptances, guarantees and letters of credit	13,254,107	9,296,374
Other liabilities	3,478,898	4,298,588
Total liabilities	367,727,790	273,627,600
Accumulated appropriations for losses	2,280,354	1,708,040
Shareholders' equity:		
Capital (see note):		
Authorized–4,000,000 (1971–3,000,000) shares, par value $5 each; issued and fully paid, 3,000,000 (1971–2,000,000) shares	15,000,000	10,000,000
Rest account	4,674,000	3,000,000
Undivided profits	321,934	138,541
Shareholders' equity	19,995,934	13,138,541
	$390,004,078	$288,474,181

Paul Austin
President

T. Sean Ahern
for Chief General Manager

NOTE TO FINANCIAL STATEMENTS

Capital:

By Order in Council dated February 23, 1971, the Government of Canada approved a special by-law increasing the authorized capital of the Bank from $10,000,000 to $40,000,000 in stages of $5,000,000 each. The first such increase became effective on the date of the Order in Council and each successive increase shall occur only after the additional shares created by the previous increase shall have been offered to and subscribed for by, or otherwise disposed of to, residents of Canada in compliance with the Bank Act. Effective January 30, 1972, each issued or unissued share of the capital stock of the Bank of the par value of $10 each was subdivided into two shares of the par value of $5 each. On March 30, 1972, the Bank issued an additional 1,000,000 shares of the par value of $5 each and consequently the authorized capital was increased to $20,000,000. On November 8, 1972, a rights issue was made involving a further 1,000,000 shares. The authorized capital of the Bank will be increased to $25,000,000 when these shares have been fully subscribed.

STATEMENT OF ACCUMULATED APPROPRIATIONS FOR LOSSES

For the Financial Year Ended October 31, 1972
(with comparative figures for 1971)

	1972	1971
Accumulated appropriations at beginning of year:		
Tax-paid—from amounts not subject to income tax ..	$ 1,603	$ 34,955
General	1,706,437	1,145,604
Total	1,708,040	1,180,559
Add (deduct):		
Appropriation from current year's operations	300,000	200,000
Provision for losses on loans based on five-year average loss experience (included in other operating expenses) less the loss experience on loans for the year	271,353	132,325
Profits and losses on securities, including provisions to reduce securities other than those of Canada and its provinces to values not exceeding market	961	225,156
Other profits, losses and non-recurring items, net	–	(30,000)
Accumulated appropriations at end of year	$2,280,354	$1,708,040
Tax-paid (amounts not subject to income tax)	$ 1,603	$ 1,603
General	2,278,751	1,706,437
	$2,280,354	$1,708,040

STATEMENT OF REST ACCOUNT

For the Financial Year Ended October 31, 1972
(with comparative figures for 1971)

	1972	1971
Balance at beginning of year	$3,000,000	$5,000,000
Premium on issuance of capital stock	1,750,000	–
Expenses of issue, net of income taxes relating thereto ...	76,000	–
	1,674,000	–
Transfer from undivided profits	–	500,000
	4,674,000	5,500,000
Special distribution to shareholder	–	2,500,000
Balance at end of year	$4,674,000	$3,000,000

HEAD OFFICE

625 Dorchester Boulevard West
Montreal 101, Quebec

BRANCHES

EASTERN REGION

Montreal: 625 Dorchester Blvd. West	André L. Morissette, Manager
Quebec City: 580 Grande Allée East	Gilles Seguin, Manager
Halifax: 1 Sackville Place	James S. Parsons, Manager

ONTARIO REGION

Toronto: 120 Adelaide Street West	Geoffrey D. Farrar, Manager

WESTERN REGION

Vancouver: 1177 West Hastings Street	John R. Pitcher, Manager
Calgary: 700, 8th Avenue, S.W.	Peter J. Lilly, Manager
Edmonton: 10030 Jasper Avenue	Brian McL. Romer, Manager
Winnipeg: 244 Portage Avenue	Maurice M. Christens, Manager

Mercantile Bank of Canada
Affiliated with First National City Bank

PRINTED IN CANADA

SECOND QUARTERLY REPORT 1972

(For the 6 months ended April 30)

Mercantile Bank of Canada
Affiliated with First National City Bank

Report to Shareholders

The public offering of 1,000,000 shares of the Bank's stock during the second quarter of the year permitted our Total Assets to surpass the $300 million mark for the first time. At the end of the second quarter they reached $355.2 million which is 45.3% higher than at the end of the same period last year. Total Loans at $305.3 million were 50% above their year-ago level while Total Deposits showed a 42.3% increase.

Total expenses, excluding interest costs, continued to demonstrate the efficiency of the Bank's operations in that they were only 11.8% above the comparative figure for 1971 while Total Revenue grew by 26.8%. Balance of Revenue rose to $2,291,054 compared with $1,495,816, an increase of 53%. The Balance of Profits for the period amounted to $1,037,054 or 52% higher than last year's $681,816. Following the offering of 1,000,000 shares, the balance of profits per share for the first six months of the 1972 fiscal year, based on the average shares outstanding, was 47.8 cents against 34.1 cents last year. With the second quarterly dividend of 12.5 cents declared, the dividends for the first half of this year total 25.0 cents per share.

Paul H. Austin, President

Statement of Revenue and Expenses

For the six months ended April 30, 1972 *(Unaudited)*

	1972	1971
REVENUE:		
Income from loans	$ 9,988,224	$7,728,328
Income from securities	404,583	608,300
Other operating revenue	826,459	514,742
Total revenue	$11,219,266	$8,851,370
EXPENSES:		
Interest on deposits	$ 5,918,708	$4,663,582
Salaries, pension contributions and other staff benefits	1,463,291	1,432,409
Property expenses, including depreciation	526,770	443,166
Other operating expenses, including provision for losses on loans based on estimated five year average loss experience	1,019,443	816,397
Total expenses	$ 8,928,212	$7,355,554
Balance of revenue	$ 2,291,054	$1,495,816
Appropriation for losses (Note 1)	229,000	100,000
Balance of profits before income tax	$ 2,062,054	$1,395,816
Provision for income taxes relating thereto	1,025,000	714,000
Balance of profits for the period	$ 1,037,054	$ 681,816
Per share (average shares outstanding) (Notes 2 & 3)	47.8 ¢	34.1 ¢
Dividends declared in the period	$ 625,000	—
Per share (Note 3)	25.0 ¢	—

Balance Sheet Highlights

Unaudited *(in thousands of dollars)*

	April 30 1972	April 30 1971
Total Assets	$ 355,168	$ 244,494
Total Loans	305,349	203,632
Total Deposits	317,436	223,001

NOTE 1
The exact amount of appropriations for losses can be determined only at the end of the financial year.

NOTE 2
Per share figures for the period ended April 30, 1971 have been adjusted for the 2 - for - 1 stock split of January 30, 1972 and are based on 2,000,000 shares outstanding.

NOTE 3
During the second quarter of 1972 an additional 1,000,000 shares were issued, bringing the total number of shares outstanding to 3,000,000.

DEUXIÈME RAPPORT TRIMESTRIEL

1972

(Pour la période du 1er novembre au 30 avril)

Banque Mercantile du Canada

Affiliée à la First National City Bank

Rapport aux actionnaires

L'offre publique de 1,000,000 d'actions de la Banque au deuxième trimestre de l'exercice a porté notre actif total à plus de $300 millions pour la première fois. A la fin du deuxième trimestre, l'actif s'élève à $355.2 millions, soit 45.3% de plus qu'un an auparavant. Les prêts se chiffrent à $305.3 millions, montant qui représente une augmentation de 50% en un an, tandis que les dépôts marquent un accroissement de 42.3%.

Les dépenses, qui ne comprennent pas le coût des intérêts, continuent de refléter l'efficacité des opérations de la banque. Elles n'ont augmenté en effet que de 11.8% en un an, alors que les revenus ont progressé de 26.8%. Le solde des revenus ressort à $2,291,054, par rapport à $1,495,816, soit une hausse de 53%. Le solde des bénéfices pour le deuxième trimestre est de $1,037,054 ou 52% de plus qu'à la date correspondante de l'année dernière ($681,816). A la suite de l'offre de 1,000,000 d'actions, le solde des bénéfices par action, pour les six premiers mois de l'exercice 1972, basé sur le nombre moyen d'actions en circulation, s'établit à 47.8 cents contre 34.1 cents l'an dernier. Compte tenu du second dividende trimestriel déclaré de 12.5 cents, les dividendes pour les six premiers mois de l'année atteignent 25.0 cents par action.

Paul H. Austin, Président

Etat des revenus et dépenses

Pour les six mois terminés le 30 avril 1972 *(non vérifié)*

	1972	1971
REVENUS:		
Revenus des prêts	$ 9,988,224	$7,728,328
Revenus des valeurs	404,583	608,300
Autres revenus d'exploitation	826,459	514,742
Total des revenus	$11,219,266	$8,851,370
DÉPENSES:		
Intérêts sur dépôts	$ 5,918,708	$4,663,582
Traitements, contributions aux caisses de retraite et autres prestations au personnel	1,463,291	1,432,409
Frais des établissements, incluant les amortissements	526,770	443,166
Autres frais d'exploitation incluant provision pour pertes sur prêts établie d'après la moyenne des pertes au cours des cinq derniers exercices	1,019,443	816,397
Total des dépenses	$ 8,928,212	$7,355,554
Solde des revenus	$ 2,291,054	$1,495,816
Viré aux réserves pour pertes (Note 1)	229,000	100,000
Solde des bénéfices avant impôts sur le revenu	$ 2,062,054	$1,395,816
Provision pour impôts sur le revenu	1,025,000	714,000
Solde des bénéfices de la période	$ 1,037,054	$ 681,816
Par action (nombre moyen d'actions en circulation) (Notes 2 & 3)	47.8 ¢	34.1 ¢
Dividendes déclarés durant la période	$ 625,000	—
Par action (Note 3)	25.0 ¢	—

Faits saillants du bilan

Non vérifié *(en milliers de dollars)*

	Au 30 avril 1972	Au 30 avril 1971
Actif total	$ 355,168	$ 244,494
Total des prêts	305,349	203,632
Total des dépôts	317,436	223,001

NOTE 1
Le montant exact viré aux réserves pour pertes ne peut être établi qu'à la fin de l'année fiscale.

NOTE 2
Le montant par action pour la période terminée le 30 avril 1971 a été ajusté en prenant en considération la division d'actions 2 pour 1 du 30 janvier 1972. Ce montant est maintenant basé sur 2,000,000 d'actions en circulation.

NOTE 3
Une autre tranche de 1,000,000 d'actions ont été émises au second trimestre de 1972, ce qui porte le nombre total des actions en circulation à 3,000,000.